

**PRINCIPLES OF MORTGAGE
LENDING IN RUSSIA:
THE PROCESS FOR
BANKERS TO ORDER AND
EVALUATE REAL ESTATE
APPRAISALS**

Prepared for

Prepared by



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PRINCIPLES OF MORTGAGE LENDING IN RUSSIA: THE PROCESS FOR BANKERS TO ORDER AND EVALUATE REAL ESTATE APPRAISALS

INTRODUCTION

This publication is not intended to be a manual on the appraisal of real estate. Rather, it is addressed to the loan officer who is knowledgeable on the subject, the professional real estate appraiser, and the professional review appraiser who may be a bank employee or an independent consultant.

The document provides for the knowledgeable loan officer the following:

- A very specific letter form that can be used to contract with the professional appraiser for the preparation of an appraisal of a specific piece of property. This letter form very carefully details the information that the appraiser is to develop as part of the appraisal process, the methodology to be followed, and the form that the conclusions are to take. It also details the support data that is to be provided (Attachment 1).
- An appraisal standards check list that the professional appraiser is to prepare and attach to the completed appraisal that will assist the loan officer and appraisal reviewer in locating the required information within the appraisal (Attachment 2).
- An appraisal review form that guides the reviewer of the appraisal through the requirements of the bank for the preparation of a satisfactory real estate appraisal. Its completion formalizes the evaluation of each appraisal and finishes with a professional opinion of the acceptability of each appraisal (Attachment 3).

ATTACHMENT 1

MODEL LETTER TO ORDER A REAL ESTATE APPRAISAL

Re: _____

Dear _____:

This letter will authorize you to prepare a fully documented narrative appraisal report on the subject property. Three copies of the report are to be submitted to the undersigned officer of the _____ Bank no later than _____. The agreed upon fee for this engagement will be \$_____ and will be payable after the appraisal report is received and accepted. In the performance of your duties, you will act solely as an independent contractor and will be entirely responsible for your acts during the performance of this assignment.

Appraisal Standards

The appraisal report must be prepared in accordance with the Appraisal Standards of the Russian Institute of Appraisers. In addition, the appraisal must fully comply with this Bank's appraisal guidelines. This appraisal will be reviewed upon receipt by the Bank and/or its consultant. Appraisal assignments are not considered complete until a review of the appraisal determines that the report is in conformity with the Bank's guidelines.

Property to be Appraised

The subject property is known as _____ and is located at _____. It consists of _____.

The property is owned by _____. Your primary contact will be _____. He can be reached by telephone at _____, to arrange for an inspection of the property and to provide all necessary data.

Purpose of the Appraisal

The purpose of this appraisal is to estimate the current market value of the real estate specified above. The appraisal report must be in a narrative format and self contained so that the logic, reasoning, judgement and analysis in arriving at a conclusion indicate reasonableness to the reader.

As you know, Market Value is defined as the most probable price that a property should bring in a competitive and open market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently and knowledgeably, and assuming the



price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of ownership from seller to buyer under conditions whereby:

- Buyer and seller are typically motivated;
- Both parties are well informed or well advised and acting in what they consider their own best interest;
- A reasonable time is allowed for exposure in the open market;
- Payment is made in terms of cash.
- The price represents the normal consideration for the property sold, unaffected by special or creative financing or sales concessions granted by any one associated with the sale.

Market Overview

The appraisal must include a separate market analysis section which covers appropriate market feasibility and absorption studies to support assumptions and value conclusions. A discussion of each of the following is required in all appraisal assignments:

- Amount of competitive space available in the market;
- Vacancy rates (if rental units);
- Amount of competitive space approved for or under construction;
- Identify if the market is in balance, oversupplied or undersupplied;
- Identify the immediate market trend;
- Sales prices and rental ranges (if rental units are part of the appraisal) for similar product type including asking prices;
- Identify properties in the market area which compete with the subject of this appraisal.

Highest and Best Use Analysis

A complete discussion of Highest and Best Use Analysis must be presented including viable alternative uses. The determination of the property's highest and best use is the first step in the valuation process which must be prepared in sufficient depth to support the market/economic feasibility of the project, and its probable success. Highest and best use may be defined as "that legal use which will yield to the property the highest present value." In forming your highest and best use conclusion, you should not lose sight of the purpose of this appraisal assignment. If the assignment calls for evaluation of a proposed project, then the final conclusion should reflect the value of the proposed project. You must present a discussion of viable alternative uses, if any, and include identification of the most appropriate use.

Cost Approach

Well chosen comparable land sales shall be used as a base to determine an appropriate underlying land value. If necessary, calculations of residual land values from building sales may be used. An adjustment grid showing percentage and/or ruble adjustments required to measure dissimilarities between the subject property and comparable properties should be included in the appraisal. As well, there should be included a map that shows the location of each land comparable as well as the subject of the appraisal. Construction cost must be carefully developed from valid sources and appropriate depreciation applied. These construction cost sources must be clearly identified and support must be presented to substantiate the validity of their findings.

Sales Comparison Approach—Completed Residential Project

You must provide a full narrative discussion of the individual sales used as comparables upon which you base your conclusions. This discussion will provide details of the sales price, number of rooms, square meters, amenities, neighborhood, confirmation of sales price, date of sale, unusual circumstances, etc. This narrative must be supplemented by preparation of an adjustment grid presenting the monetary and/or percentage adjustments for dissimilarities between the comparable unit sales and the units that are the subject of the appraisal. Should the expected sales period exceed twelve months, then the cash flow stream from sales must be discounted.

Income Capitalization Approach

(If commercial property is included within the residential project).

All assumptions used in determining value on this basis, such as rents, expenses, vacancy, credit loss, absorption, along with capitalization and discount rates must be fully supported and all sources of data and all publications specifically referenced. If applicable:

- Above/below market leases must be appropriately noted and their implication on market value analyzed;
- Historical financial information concerning the subject property, e.g. revenues, vacancy and credit loss rates, expenses, capital improvements, etc. must be disclosed and thoroughly analyzed;
- Reports must address the estimate of value as completed but not occupied under the indicated highest and best use of the property to be appraised. This estimate of completed value must be based on projected revenues, vacancy and credit loss, operating expenses and tenant improvements during the leaseup period. Appropriate deductions and discounts for the leaseup and absorption period must be incorporated in the analysis. Such deductions and discounts are considered to be those that reflect all expenses associated with



the disposition of the real property, as of the date of completion, as well as the cost of capital and entrepreneurial profit.

- Appraisals must address the estimate of completed value based on proposed improvements if different from the highest and best use estimate. Such estimates should be based on the property being completed but not occupied and as being stabilized but properly discounted for the appropriate absorption period.

Miscellaneous

When there is a clear indication that the subject is encumbered by a lease instrument or legal limitation which may impact its use, the appraisal report must include an assessment as to what degree such lease term or limitation may have on the value of the property appraised.

- The appraisal must analyze and disclose in reasonable detail any prior sales of the subject property in the three years preceding the date of the appraisal report as well as any current agreement of sale, option, or listing for sale of the property being appraised.
- If research determines that the property is located in a highly speculative local market area that has experienced dramatic price increases relative to regional norms, a sales history analysis of the subject property, as well as any comparables used, must be fully documented.

Environmental Issues

The appraisal should not take environmental issues into consideration. Nevertheless, the appraiser should notify this bank upon the observation or discovery of any apparent environmental hazards such as evidence of waste disposal, paints, chemical residues, oil spillage or such other potential environmental hazards as underground storage tanks. In addition, appropriate notation must be made of flood hazard areas and any other environmental acts and regulations you observe that could impact market value.

Documentation Required In This Appraisal

- Legal description of the property appraised;
- Signed copy of this letter;
- Signed Appraisal Checklist with the appropriate page numbers referenced.

Report Preparation and Review

This engagement letter and all terms herein are confidential and may not be released by you without the written consent of this bank. The assignment to make this appraisal is being contracted with you and it is understood that you will inspect the subject property and personally prepare or supervise the preparation of the report.

In the event that, following this bank's review of the completed appraisal, it is discovered that standards have not been met, it will be returned to you and corrective actions must be completed within 15 days of notification.

Sincerely,

ATTACHMENT 2

MODEL APPRAISAL STANDARDS CHECKLIST (To Be Completed by the Appraiser)

Please indicate if each of the following items have been addressed in the appraisal you have prepared.

A "no" answer indicates noncompliance with bank standards and requires a separate written explanation. If an item is not applicable indicate "n/a".

Please indicate on which page of the appraisal the information is included.

YES/NO	PAGE No.	
_____	_____	(1) Certification that the report conforms to Uniform Russian Standards of Professional Appraisal Practice (URSPAP)
_____	_____	(2) Does appraiser have appropriate knowledge and experience required to complete an appraisal competently?
_____	_____	(3) If no, was this fact disclosed as well as steps taken to comply with the competency provision of URSPAP?
_____	_____	(4) Is/does the appraisal document:
_____	_____	(a) Written and presented in narrative form
_____	_____	(b) Sufficiently descriptive to enable the reader to ascertain the estimated market value and rationale
_____	_____	(c) Provide detail and depth of analysis that reflects the complexity of the real estate appraised
_____	_____	(5) Analyzed and reported, in reasonable detail, prior sales of the property:
_____	_____	(a) For 1-4 family residential property - sales occurring during the prior one year;

[illegible]

- (b) For all other properties - sales occurring within the three preceding years
- (6) On income producing property, analyzed and reported data on current:
 - (a) Revenue;
 - (b) Expenses;
 - (c) Vacancies; and
 - (d) States if the property will continue to be income producing.
- (7) Analyzed and reported a reasonable marketing period. Were the underlying assumptions for the basis of the marketing period disclosed?
- (8) Analyzed and reported on market conditions/ trends that will affect projected income of absorption period for subject property regardless of whether the trend reflects rising or declining values.
- (9) Analyzed and reported discounts/deductions for:
 - (a) Proposed construction;
 - (b) Completed projects partially leased;
 - (c) Projects leased at other than market rents; or
 - (d) Residential developments with unsold units.
- (10) Include certification that the appraisal was not based on requested:
 - (a) Minimum valuation;
 - (b) Specific valuation or value within a given range;
 - (c) Approval of a loan.



		(11) Contains sufficient documentation to assess appraiser's logic, reasoning, judgement, and analysis, i.e.:
		(a) Does the appraisal refer to supporting documents (i.e., engineers report, environmental studies);
_____	_____	(b) Are the supporting documents contained or summarized sufficiently in the appraisal report or readily available to the reader?
		(12) Adequate legal description of property including:
		(a) A legal description found on a transfer instrument (i.e., metes and bounds description); or
_____	_____	(b) Filed survey map or recorded plan.
_____	_____	(13) Separate valuation if applicable of:
		(a) Personal property;
_____	_____	(b) Fixtures;
_____	_____	(c) Intangible items; and
_____	_____	(d) Impact of their inclusion/exclusion on the estimate of market value discussed.
		(14) Used reasonable valuation method:
_____	_____	(a) Direct sales comparison;
_____	_____	(b) Income;
_____	_____	(c) Cost approach;
		(d) Reconciled approaches used and/or explained elimination of each approach not used
_____	_____	(15) If information was unavailable, that fact was disclosed and explained in the appraisal.
_____	_____	(16) Was the property valued in its "as is" condition?
_____	_____	

ATTACHMENT 3

MODEL APPRAISAL REVIEW SHEET

BORROWER _____
PROPERTY ADDRESS _____

PROPERTY TYPE _____
APPRAISER NAME _____
DESIGNATION _____
APPRAISAL COMPANY _____
VALUE & EFFECTIVE DATE _____ DATE _____
ACCOUNT OFFICER _____
REVIEWER _____
SIGNATURE _____ DATE _____

INTERESTS VALUED	REAL ESTATE VALUED
Fee Simple _____	Land _____
Leased Fee _____	Land & improvements _____

VALUE ESTIMATE	LIMITING CONDITIONS
"As is" _____	Consistent w/Valuation Process _____
"As built" _____	Unreasonable or Excessive _____
See comments _____	

REVIEWER'S CONCLUSIONS AND RECOMMENDATIONS

SCOPE OF REVIEW	Y or N
Read Report	_____
Interviewed Appraiser	_____
Inspected Property	_____
Appropriate Appraisal Methods & Techniques	_____
Appropriate Analyses, Opinions & Conclusions	_____

RECOMMENDED ACTION	
Accept Appraisal	_____
Reject Appraisal	_____
Have Appraiser Revise/Update	_____
Have Property Reappraised	_____

PROPERTY IDENTIFICATION & LOCATION

WERE THE FOLLOWING ITEMS INCLUDED	Y or N
Property Location Address	_____
Legal Description	_____
Three Year History of Ownership	_____
Real Estate Tax Information	_____



ARE THERE ANY Restrictions To Ownership Rights _____ Y, N, Unknown
Easements _____
Current Agreements of Sale, Listing, or Option _____

DOES THE APPRAISAL ADEQUATELY DESCRIBE Y or N
Regional Data _____
Local Data _____
Competitive Market _____
Trends in the Subject Market _____

DESCRIPTION OF THE PROPERTY

DOES THE APPRAISER ADEQUATELY DESCRIBE

SITE Y or N
Physical Features _____
Zoning _____
Title Encumbrances _____
Available Utilities _____
Actual or Potential Site Problems:
 Flood Potential _____
 Environmental Conditions _____

IMPROVEMENTS

Physical Features _____
Quality _____
Functional Utility _____
Age _____
Condition _____
Hazardous Conditions _____

HIGHEST AND BEST USE ANALYSIS

WERE THE FOLLOWING ITEMS PROPERLY DISCUSSED

Y or N
Definition of Highest and Best Use _____
"As if Vacant" _____
"As if Improved" _____
Zoning Conformity _____
Legally Possible _____
Physically Possible _____
Financially Feasible _____
Maximally Productive _____

CONCLUSION OF HIGHEST & BEST USE WAS _____

CURRENT ZONING _____

VALUATION

COST APPROACH

Y or N or N/A

If Approach Not Developed Is Explanation Adequate _____

SITE

Comparable Sales Adequately Described _____

Reasonable Adjustments Made _____

IMPROVEMENTS

Data Adequate For Conclusion _____

Source of Cost Data Appropriate _____

Three Forms of Depreciation Discussed _____

Entrepreneurial Profit Explained _____

Appropriate Adjustments Made For Proposed Construction _____

SALES COMPARISON APPROACH

Y or N or N/A

If Approach Not Developed Is Explanation Adequate _____

Are Comparable Sales Adequately Described _____

Are Significant Elements of Comparison Properly Considered _____

Are Reasonable Adjustments Made _____

ESTIMATED LENGTH OF MARKETING PERIOD _____

INCOME APPROACH

If Approach Not Developed Is Explanation Adequate _____

Historical Occupancy Analyzed _____

Current Income and Expenses Adequately Reviewed _____

Existing Leases Adequately Analyzed _____

Comparable Rents Properly Compared _____

Subject's Expenses Reasonable _____

Stabilized Operating Statement Consistent Historically _____

Adequacy of Data & Support For:

Absorption Period _____

Income Growth Rates _____

Expenses _____

Discount Rates _____

Capitalization Rates _____

Appropriate Discounts Made For Partial Leasing _____

Appropriate Adjustment For Other Than Market Rents _____

RECONCILIATION OF VALUE

INDICATED VALUES

"As is"

"As built"

" Other"

Cost Approach	_____	_____	_____	_____
Sales Comparison Approach	_____	_____	_____	_____
Income Approach	_____	_____	_____	_____
Value Conclusion	_____	_____	_____	_____

CONFORMANCE TO POLICY

Y or N or N/A

Was "As is" Value Estimated	_____
Was "As Built" Value Estimated	_____
Was Marketing Time Estimated	_____
If Marketing Time > 12 Months, Was Value Discounted	_____
Was Discounting Process Adequately Supported	_____
Engagement Letter Included In The Report	_____
Is Current & Future Employment Not Contingent On Value Stated	_____
Do Personal Property, Fixtures or Intangibles Affect Value	_____
If So, Are They Evaluated Separately	_____
Is Explanation Of Appraiser's Competency Satisfactory	_____
Is Appraiser On The Bank's Approved Appraiser List	_____
If Not, Why Accept The Report	_____

COMMENTS AND CONCERNS

This image shows a single sheet of white paper with horizontal blue or grey ruling lines. The lines are evenly spaced and run across the width of the page. There are approximately 20 lines visible. On the left side, there are three short vertical lines that appear to be part of a margin or binding edge. The overall appearance is that of a clean, unused piece of stationery.

(Use additional pages as necessary)

Reviewer _____ Date _____